Submission to the federal

STUDY GROUP ON DISPUTE RESOLUTION PROCEDURES

related to the

MUNICIPAL GRANTS ACT

presented by the

Federation of Canadian Municipalities

Ottawa, January 28, 1982

SUMMARY

Through the establishment and expansion of grants in lieu of taxes, the federal government has over the last 30 years increasingly recognized its obligation to share like other property owners in the costs of municipal services. The Municipal Grants Act, 1980 is further evidence of the federal commitment but, despite the improvements afforded, there are still deficiencies in the program as the existence of this Task Force indicates. The Federation sees three major concerns relating to the appropriate scope and/or structure of an appeals process. These concerns are identified next. Implications and recommendations for the appeal process follow.

UNRESOLVED ISSUES

Exemptions: Many types of federal properties and structures are exempted from grants in lieu of taxes although often benefitting from municipal services and although this treatment is contrary to provincial practices for similar private and public properties. However, full taxation may be as inappropriate as complete exemption. In many cases, special treatment (as is already commonly provided similar property) may be required to maintain a reasonable relationship between grants in lieu of taxes and local expenditures on behalf or account of the property.

Treatment of Business Occupancy Taxes: Only federal properties associated with Crown corporations expected to earn a reasonable return on investment are required to pay grants in

lieu of business tax. This is an irrelevant criterion, however, because municipal services are required by federal properties regardless of their profit orientation. The federal government should admit to the legitimacy of business occupancy taxes as a means of financing and distributing the cost of municipal services, particularly since it is effectively already paying them in provinces where they are linked directly to the property tax base. The link to the property tax base is an artificial distinction and is a source of interprovincial inequities easily corrected.

Ministerial Discretion: Grants in lieu of tax are established at whatever "in the opinion of the Minister" should prevail. Property values may be arbitrarily reduced to effect this and, although the move may be discussed and negotiated, the Minister has the final word for there is no appeal. Because the sole arbitrator is both judge and litigant, municipalities often feel that they have not been fairly heard. This issue is the immediate focus of the Task Force.

APPROACHES TO AN APPEAL PROCESS

No Appeal: The possibility of maintaining the status quo cannot be ignored. However, in face of repeated criticism and in view of this Task Force, it appears that the inadequacies of the present arrangement are recognized and that this alternative can be dismissed as unacceptable.

The Federal Government as a Normal Taxpayer: At the other extreme, the federal government might assume the position

of a normal taxpayer as has been advocated by the provinces and, indeed, previously by this Federation. In this case, the appropriate federal grant in lieu of tax would be determined according to the policies and practices of the municipal and provincial governments in which the property is located. Any disagreement would be heard by the regular provincial board responsible for hearing property tax appeals. However, such a stance erodes the constitutional position of the federal government vis-à-vis other governments on taxation matters.

A Delegated Federal Appeal Board: The federal government could maintain its constitutional standing while employing the provincial property tax appeal boards if, in cooperation with the provinces, the provincial boards were delegated the responsibility for hearing assessment appeals relating to federal property. In this case, the provincial boards, possibly modified by the addition of a federal appointee, would become the federal agent for hearing appeals concerning federal properties and, presumably, according to federal guidelines. This alternative minimizes the need for further boards or tribunals and accesses the existing expertice and machinery.

A Federal Appeal Board: The federal government could maintain an independent stance by establishing its own appeal board(s). The difficulties in creating such bodies in each province could be considerable. Some of those problems could be avoided by establishing a more restricted version of an appeal

authority, a single national board with pre-screening machinery, designed to identify and address only the more serious cases. This alternative could maintain the position that it is the municipality which could appeal the federally determined grant in lieu rather than the federal government appealing as taxpayer.

On Choice and Scope of An Appeals Process: While the delegated board offers a logical choice, the need for a reasonable appeal process is more important than the particular choice among workable alternatives. But disputes over property values are only one aspect of the problem that need consideration. Arbitrary and exceptional treatment leaves potential for inappropriate and unfair treatment, and dissatisfaction. Hence, the scope of an appeals authority should be expanded to cope also with problems involving exemptions and business taxes. Fundamentally, the appeal authority should be empowered to deal with any case in which a municipality considers itself fiscally disadvantaged by the presence of federal property.

The Federation of Canadian Municipalities is pleased to appear before this Task Force and participate in the continuation of recent efforts to improve the system by which the federal government determines grants in lieu of taxes for municipalities (and other authorities levying real property taxes). The Task Force is to study and make recommendations on an appeal process and we address that issue explicitly in the final portion of the submission. However, because we believe it inappropriate (perhaps even impossible) to divorce entirely that issue from other related concerns, this submission also discusses the major inadequacies of the existing federal grants in lieu of tax mechanism - faults with which an appeal process must cope and to which it must relate. A brief historical review outlines developments to date.

INTRODUCTION AND HISTORICAL REVIEW

Although Crown property is exempt from taxation under the provisions of Section 125 of the B.N.A. Act, the federal government has since 1950 made payments of grants to municipal governments in lieu of property taxes for general and school purposes and of local improvement levies. Initially, these grants were paid only to municipalities in which federal government property exceeded four percent of the total (federal plus taxable) property value. That restriction was removed as of 1957. In 1967 federal government agencies were instructed to pay full grants in lieu of taxes if not already doing so.

The Federation of Canadian Municipalities was instrumental in promoting the federal government to adopt these reforms and in so doing to recognize its responsibility to compensate municipalities for the loss of revenue and the direct and indirect servicing costs imposed upon them because of the presence of federal property within their jurisdictions. Aspects of the Municipal Grants Act have, however, been a continuing concern to municipalities and their Federation. In 1975 and 1977 in particular, the Federation appealed to the federal government to make a number of urgently required revisions to the Act. The areas of concern were:

a) the divergence between the assessed values of many federal properties and the values which the federal government accepted for grant in lieu of tax determination;

b) the excessively broad definition of federal property exempted from grant in lieu of tax;

c) the unduly narrow range of federal properties required to pay grants in lieu of local commercial or business taxes;

d) the deductions from grants in lieu for un-used and/or self-provided services; and

e) the lack of uniformity in the determination of payments in lieu by Crown corporations.

Support for the municipalities' position has also come from the provincial governments. Since 1973, the Conference of Ministers of Municipal Affairs has been studying tax exempt property and federal and provincial grants in lieu of taxes. Provincial concern was stimulated in part by municipal representation

at the provincial level and by provincial inquiries into local taxation which frequently criticized the grant in lieu of tax programs of both provincial and federal governments. Those developments spurred some improvement of provincial programs and led the provinces to petition the federal government to revise its grants in lieu scheme also. The basic thrust of this early initiative was a call for an expanded federal program. More recently (since amendments to the Municipal Grants Act were considered) the provinces have proposed that the federal government commit itself and its agencies to grants in lieu equivalent to full property taxes and assume the position of a normal property taxpayer bound by the relevant practices in each province.

In response to the municipal and provincial representations, the federal government announced in 1978 its intention to amend the Municipal Grants Act. A revised Act, Bill C-46 was introduced in the House in March of 1979 and thereafter the municipal and provincial positions focused on the specifics of the proposed legislation. The bill appeared before the House in essentially the same form; first as C-46, then in October 1979 as C-3, and finally as C-4 in April 1980. Bill C-4 (The Municipal Grants Act, 1980) was passed and proclaimed on December 1, 1980.

The new Municipal Grants Act includes several provisions making the federal grants in lieu of tax program more comprehensive. First, the range of federal government property

exempted from grants in lieu was reduced to urban parkland, Indian reserves and structures not for shelter such as canals, roads, runways, docks, penitentiary walls, reservoirs, water and sewer mains. Other properties previously exempt included parks, historic sites, museums, libraries and galleries, self-contained defence establishments, and the Houses of Parliament, the Peace Tower and the parliamentary library. Second, the list of Crown corporations required to make payments in lieu of tax was enlarged and the extent of their encumbrance further specified. In particular, a schedule of Crown corporations required to make grants in lieu of business occupancy taxes (besides real property taxes) was provided. Third, for purposes of calculating the grant, no uniquely preferential tax rate would be used. Hence, the federal government is to utilize the same rates applying to taxable property. Fourth, the occasions in which the federal government would make deductions for services not "accepted" was reduced but the right to make deductions for services normally provided taxable property but not provided to federal property was retained. Deductions may still be made for education services not accepted but not for municipal services such as refuse and fire and police protection. Also, the federal government is to extend somewhat the payment of grants in lieu with respect to property leased to private tenants. Efforts have also been made to hasten the payment of grants in lieu. Certain changes implemented under this legislation are being phased in over a four year period.

Although this Act addressed a number of issues concerning municipal and provincial governments, it did not resolve all the problems. Presentations by municipal and provincial governments relating to the legislation revealed several areas of contention. Rather than delay passage of the bill and postponement of the benefits it provided, the Minister of Public Works (the Hon. P.J. Cosgrove) committed the government to the establishment of a study group to further assess federal grants in lieu of tax and specifically an appeals process. Despite the improvements afforded by the Municipal Grants Act, 1980, there are three major areas of concern remaining about federal grants in lieu of tax - exemptions, the treatment of business taxes, and ministerial discretion. The federal government continues to exclude from the determination of payments in lieu of tax many properties which if privately owned would be subject to municipal taxation. Not only are grants in lieu of business taxes not paid on departmental properties but they are also not required from many federal agencies (see Schedule III of the Act) engaged in business-like operations. The Minister has the power to modify the assessed values of federal properties (from those established by assessment authorities) and the effective tax rates for the purposes of calculating grants in lieu of municipal taxes. Although such changes are "negotiated", the municipality has no recourse or appeal to an independent authority. The purpose of this Task Force and these hearings is to study ways of dealing with this latter issue although it is anticipated that this will be only the initial phase of a broader

investigation. Since the appeal process can only be understood and appreciated in the context of the broader question due to the interrelationships involved, the Federation's concerns for all three issues are elaborated upon in the following section prior to dealing specifically with potential approaches to the appeal process in the final portion of this brief.

UNRESOLVED ISSUES

Exempt Properties

Despite the revisions to the Municipal Grants Act reducing significantly the extent of federal properties exempt from grants in lieu of tax, many exemptions remain which can logically be challenged. Where exemptions occur, an additional burden is imposed upon the remaining taxpayers. This is unfair, particularly in municipalities where the portion of exempt property is unusually high, and is contrary to the federal government's intention of making payments in compensation to municipalities for lost revenue or for costs incurred on behalf or on account of federal properties. Federal properties are provided for the general benefit of all Canadians and their full costs, including those placed upon the municipalities, should be met by Canadian taxpayers.

The exemption of a wide range of federal structures creates a number of anomalies because often similar privately-owned properties are taxable. While the rationale for exempting certain kinds of structures (such as roadways, aircraft runways,

and canals) is widely accepted, the logic for exempting such properties as transmission lines, communication towers, storage tanks, drydocks and wharves is nebulous, especially when such facilities are assessed and taxed in most provinces. Admittedly, because of the particular nature of such properties and their impact upon municipal authorities, properties of this sort are often subject to special property tax provisions in order to maintain a reasonable relationship between taxes paid and local expenditures incurred on their behalf or account. Rather than being exempt from payments in lieu, federal properties of this kind should be treated in a parallel fashion so that the municipalities in which they are located not be fiscally disadvantaged by the federal presence. This refinement could be accomplished either by adopting the tax practices of the province in which the property is located or by establishing a nationwide procedure representative of the provincial approaches.

Also exempt is a class of property that is uniquely federal (or at least governmental). Included within this are gun butts, monuments, penitentiary walls and urban parks. While the exemption of such property may be appropriate in some cases, it may be unsuitable in others. Special tax treatment (as above) or the ability to appeal when grants in lieu were felt justifiable, rather than complete exemption, would be a more reasonable approach to the treatment of this kind of property.

Though required to make payments in lieu of property taxes, many federal properties are exempted from grants in lieu

of business taxes. Because this is a particularly important concern, it is dealt with separately.

Treatment of Business Taxes

Only selected Crown corporations pay grants in lieu of business occupancy taxes. Those required to do so are listed in Schedule IV of the Municipal Grants Act and includes, for example, Air Canada, Canadian National Railways, Eldorado Nuclear, and Petro-Canada. Payments in lieu of business taxes are not made for departmental properties nor by federal authorities appearing in Schedule III although it includes many undertaking ventures of a commercial sort - e.g. Canadian Broadcasting Corporation, The Canadian Wheat Board, Farm Credit Corporation, Radio Engineering Products Limited, and VIA Rail - often with private sector parallels. To the extent that the equivalent of business taxes are not paid, municipal governments and their local taxpayers are in effect required to subsidize federal activities benefitting all Canadians. It is neither the role of municipal government to support other governments nor is it fair that the burden of doing so be imposed upon the local taxpayer in which the particular property is located rather than taxpayers in general.

Several arguments have been advanced as to why the federal government should not pay grants in lieu of business tax but none are convincing. Foremost is the point that the government is not engaged in those operations to make a profit

but rather to provide a service. Consequently, the designation of federal agencies required to pay grants in lieu of tax turns on their financial independence from Parliament. This criterion is at odds with the espoused principle of making compensation for services and, indeed, from the municipal perspective is irrelevant. The anomaly is especially evident when the revenue accruing to a municipality from a property varies with the occupant although both place the same demands on municipal services. Municipalities view business occupancy taxes as an additional levy to meet the costs of the extra services associated with business activities. Whether this is a valid or a complete view of their role is debatable but the position has not been disproven.[1] Some reconciliation might be possible if the business occupancy tax was simply regarded as an occupancy tax since the municipal costs are related more to occupancy than the nature or purpose of the occupant's activities. Even if taxes on businesses (or occupants) and the costs of services to them are not closely related, the case for business taxes and grants in lieu of them could not be refuted. The existing pattern of local taxation, including business taxes, is a widely accepted method of distributing the municipal tax burden and there is no reason that the federal government should interfere with or reject that. Benefits received are not the only acceptable basis for allocating tax burdens. Each taxpayer should also be prepared to pay a fair share of the cost of community services even if not directly or immediately benefitting providing that similar taxpayers are

1 R.W. Boadway and H.M. Kitchen, Canadian Tax Policy, Canadian Tax Foundation, May 1980, pp. 178-180.

treated in a parallel fashion; a point the federal government has already conceded in withdrawing from many of the deductions previously made for services not accepted.

A second argument against a broader federal commitment to the payment of grants in lieu of business taxes is the non-uniformity of the tax base which, it is argued, would lead to interprovincial inequities. In fact, the failure to recognize business taxes as a legitimate form of municipal taxation (despite the fact that it accounts for about 10 percent of municipalities' own-source revenues) is presently a source of interprovincial disparities in the federal government's treatment of municipalities. Where the business tax is tied to the property tax base as in Prince Edward Island, the federal government is in effect currently paying grants in lieu of the business tax, but, where the tax is associated with one of its many other bases, such is not the case. While revision of the structure of the business tax could circumvent the municipalities' problems, it is not the place of the federal government to promote such changes. Rather, the federal government should recognize the business taxes (perhaps better regarded as occupancy taxes) as a valid municipal revenue source and the lack of a direct link between it and the property tax base as an artificial distinction.

Occasionally fear has been expressed that if the federal government consented to payments in lieu of business taxes it would (partly because of the non-uniformity of bases and rates) leave itself open to exploitation by municipal authorities. While the

possibility might exist in some circumstances, the argument certainly seems greatly exaggerated particularly in view of the experience of Crown corporations making such payments. Furthermore, an effective tax rate with respect to property assessment could be imputed for federal property from the ratio of business tax revenues and the assessed values of the properties whose occupants are liable for that tax. Given the variety of bases, such an approach may be quite reasonable as a practical matter even in the absence of (imagined) fears of municipal exploitation.

Comments by federal representatives suggest that the federal government might adopt a more lenient attitude towards payments in lieu of business taxes if the budgetary situation were less severe. If so, it is unfortunate that fiscal expediency overrides principle and willingness to admit to financial obligations.

Ministerial Discretion

The two major factors employed in the calculation of grants in lieu, the effective rate and the property value, are both those that "in the opinion of the Minister" should prevail. Given the government's intention to adopt the same tax rates that would apply if the property were taxable, the more contentious point is that the property values employed can be devalued at the will of the Minister from the assessed values established by assessment authorities. For example, reductions are customarily made for "ornamental, decorative or non-functional features" - items given explicit consideration in the Act. Such devaluations

are not the rule since assessed values are frequently accepted. However, a survey by the Federation indicated that accepted values averaged about 95 percent of assessed values and, of course, in some cases the discrepancy was much greater.

When differences of opinion arise as to the appropriate value to be placed on federal property, the issue is discussed and negotiated. Yet the Minister has the final word and there is no appeal. While this is certainly an efficient mechanism for deciding the matter, municipalities can hardly regard their position as being fairly heard when the sole arbitrator is both judge and litigant. The federal government is unlike any other taxpayer in that it is able to determine its own assessment and tax rate if it so wishes. The federal rationale for its unique position is that it is not a taxpayer and municipalities are not entitled to grants in lieu of property taxes. Rather the government is merely making a transfer to municipalities at its own discretion. For the same reason, it is argued that the federal government need not submit to the normal mechanisms and procedures for settling disagreements about the appropriate payment. It is undoubtedly true that constitutional provisions give the federal government special status in this area, but as a practical matter the federal government has over the last 30 years increasingly recognized its obligation to municipalities. The remaining issue is to get it to accept its full responsibility. So long as federal property is treated in an exceptional manner and an unbiased appeal process does not

exist, dissatisfaction with federal payments in lieu of taxes will persist.

Before addressing the specifics of alternative appeal processes, it is useful to briefly review the provincial approaches to the grants in lieu of tax question for their situation in many ways parallels that of the federal government.

A Brief Review of Provincial Grants in Lieu of Taxes

The provincial approaches to grants in lieu of taxes varies widely. On the one hand, all provincial property in Prince Edward Island is subject to municipal taxes and New Brunswick pays grants in lieu on all provincial property while in Saskatchewan payments on government-owned property only covers local improvement levies and not municipal or school taxes as in customary elsewhere.[2] In many cases certain types of provincial properties, e.g. educational facilities and hospitals, are exempted in whole or part from grants in lieu. The federal government, however, exempts a somewhat wider range of structures than is generally the case for provinces. Payments in lieu of business taxes may be made "when appropriate" (e.g. Alberta, Manitoba and Ontario) by government enterprises such as liquor boards and Crown corporations. Only Quebec has undertaken to pay business occupancy taxes on departmental property. This move was made as part of its 1980 municipal fiscal reform which included the extension of grants in lieu on a variety of provincial properties. Generally speaking, disagreements over provincial grants in lieu of tax

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2. Not all provinces pay grants in lieu of school taxes (e.g. Quebec) on the basis that schools are supported directly.

cannot be appealed as the provincial governments, like the federal, make the final decision.

ALTERNATIVE APPROACHES TO THE APPEAL PROCESS

An appeals process might be structured to suit any of a variety of approaches. Here we identify and comment on some alternatives. In addition, we make recommendations for the scope as well as the structure of an appeals process.

No Appeal: Continuation of the Existing Arrangement

The possibility of maintaining the status quo cannot be ignored. However, in the face of repeated criticism and in view of the establishment of this Task Force, it appears that the inadequacies of the present arrangement are now recognized and this alternative can be dismissed as unacceptable. It is hoped so.

The Federal Government as a Normal Taxpayer

At the other extreme, the federal government could assume the position of a normal taxpayer. In this case, the appropriate federal grant in lieu of tax would be determined according to the policies and practices of the provincial and municipal governments in which the property is located. Federal property would be assessed by the relevant authority in a province in compliance with its procedures and the local tax rates applied as they would be to similar taxable property. Any disagreement over the payment in lieu of tax so determined would be heard by the regular provincial board responsible for hearing

property tax appeals. Were the federal government to adopt this position, it would be treated similar to other property taxpayer in each province. Such a move would be consistent with the evolving federal stance that grants in lieu of tax be determined on the same basis as if its property were taxable. Furthermore, this approach is most consistent with provincial views as to their authority in the property tax area.

It is to be expected that the federal government would find this alternative unacceptable. Previous statements indicate that the federal government is not prepared to jeopardize its constitutional standing on taxation of its properties by relinquishing some of its powers in the area to provincial and municipal governments despite their historical domination of the field and the existence of established authorities under them capable of dealing with those issues. On a more pragmatic level, the federal government will certainly reflect on the fact that while the provinces (and this Federation) have advocated this position, the provinces do not generally permit the same privilege to their own municipalities. (Although if the federal government adopted such a position, the onus would be upon the provincial governments to follow the federal initiative.) In these circumstances, it does not seem unreasonable to respect the federal position on its standing relative to other governments, especially if the same result might be attained in an alternative fashion as suggested below.

A Delegated Federal Appeal Board

The thrust of this proposed alternative is a blending of the advantages of the previous alternative within a mechanism which would not threaten the federal government's standing vis-à-vis other governments. This could be achieved by the federal government, in cooperation with the provinces, delegating the assessment appeal process to the provincial property tax appeal boards. With provincial approval, the provincial boards (possibly with modifications such as the addition of a federal appointee) would become the federal agent for hearing appeals.

This arrangement affords some significant advantages. The expertise and competence of the existing authorities would be accessed. The new federal agent would already be familiar with provincial policies and procedures. The bulk of the required machinery already exists and could readily be extended and modified as necessary to cope with the additional responsibilities.

An important policy problem arises under this prospect. Would federal property be assessed for grants in lieu of tax according to provincial policies or according to federal guidelines? The provinces would likely prefer to see the federal government treated as an ordinary taxpayer for the reasons cited above even though this would usually mean a discrepancy in the treatment of federal and provincial property. To ensure similar treatment among municipalities across the country, the federal government would prefer nationally uniform federal criteria.

Both positions have some merit and would undoubtedly be the topic of intense discussion if this approach were to be pursued. If the federal position were offered, some provinces at least might be put under some pressure to accept it in order to open to their municipalities an appeal process. Although posing a policy problem due to the need for federal-provincial cooperation, this alternative does offer the potential of functioning well under either choice.

A Federal Appeal Board

The federal government could continue its grant in lieu of tax program independent of provincial policies by establishing its own appeal boards to hear cases involving federal property. Because following such a course requires establishing new tribunals or boards, it too becomes complicated. Most important is the difficulty of obtaining qualified board members and support staff particularly when it might be necessary that some are familiar with the situation in more than one province or serve only on a part-time basis. Some of these problems could be avoided by establishing a more restricted version, a single national board with a pre-screening mechanism, designed to identify and address the more serious cases.

An important distinction is to be noted here. Whereas in the previous two cases the situation would be that the federal government could appeal the assessment made against it for grants in lieu of tax, in this case it is the municipalities which could

appeal the grants in lieu decided upon by the federal government. This consideration may be important from the federal perspective.

On the Choice of Alternatives

In this review of alternatives, the delegated federal board stands out as the most logical choice. Although the need for federal-provincial cooperation poses a potential policy conflict, surely federal-provincial negotiation could resolve the issue. It must be emphasized, however, that the need for a reasonable appeal process is of greater importance than the particular choice among workable alternatives.

Comment on the Scope of an Appeal Process

The above discussion of alternative approaches to an appeal process relates to the settlement of disagreements over assessments as is the focus of the Task Force. However, as the discussion of unresolved issues illustrated, so long as federal properties are afforded exceptional treatment the potential for inappropriate and unfair treatment of municipalities, and so their dissatisfaction, exists. This could be corrected by amending the Municipal Grants Act to further reduce exemptions and recognize business occupancy taxes in addition to establishing an appeals process. Alternatively, the most serious problems arising out of those concerns could be dealt with by enlarging the scope of the appeal process to enable the appeal authority to hear (subject to certain guidelines) cases involving exemptions and business taxes. Municipalities adversely affected by

prevailing federal practices and policies in these areas could put forth their cases and the more serious cases could be reconciled this way. The basic criterion the appeal body should follow in ruling on those cases is that a municipality should not be fiscally disadvantaged by the presence of federal property (i.e. suffer a net negative fiscal impact). Indeed, that criterion should underlie the whole grants in lieu of tax program.